

Audit Committee Communication: What is said, why, how and to whom?

Paper prepared for the Audit Committee Chair Forum

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The Audit Committee Chair Forum (ACCF) is convened by the CBI and Ernst & Young and is facilitated by Cranfield University.

The Forum comprises a select group of audit committee chairs from the UK's leading companies. Our aim is twofold, namely:

- to influence the direction of regulation as it impacts audit committees, and
- to act as a vehicle to develop points of view and best practice.

The Forum provides an opportunity to contribute to the debate, influence its direction and improve the performance of audit committees.

The Forum is currently chaired by John Buchanan, Audit Committee Chairman of AstraZeneca, with Gerald Russell, Senior Partner at Ernst & Young, and Martin Broughton, Non Executive Chairman of British Airways, as vice chairs.

This is the fifth paper produced by the ACCF. Previous papers include:

- What is an effective audit and how can you tell?
- The drivers of audit quality
- Audit Committee regulation: 'Financial literacy' – what does it mean?
- The role and function of the Audit Committee

To obtain copies or discover more about the ACCF please contact the Forum Secretary, Gordon Cole at the CBI, gordon.cole@cbi.org.uk



Executive summary

- The way an audit committee communicates needs to reflect the context of its relationship with the Board, which differs in every company.
- In order to be of most use, minutes should be prepared and distributed very shortly after the meeting. However, processes varied widely.
- The style of audit committee meeting minutes is diverse; some are brief and anodyne, others are fuller and capture the essence of the discussion. The most important aspect of the minutes is the list of action points.
- Opinion diverged as to the usefulness of the committee's formal minutes. Some took the view that they did not matter, others saw them as an important tool in managing relationships, and in supporting the finance director where appropriate.
- More important than the formal minutes is the oral briefing given to the Board by the Chair of the audit committee. This is generally both timely and comprehensive. It is one way in which all Board directors can assure themselves that they are complying with their legal responsibilities on making full disclosure to the external auditors.
- The published report of the audit committee, included in a company's annual report and accounts, is seen as a compliance matter and not as a helpful form of communication. Extending its coverage was not seen as appropriate.
- The audit committee operates as a sub-committee of the Board, but in all critical matters its role is that of review rather than action. Accordingly, it was considered that there is no need for any increase in the level of communication – formal or informal – between the committee and investors.



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Introduction

The audit committee is charged with monitoring and reviewing the company's published financial information, its audit, and its internal control systems. In carrying out this remit, the committee will have formal and informal communication with fellow directors and the Board as a whole. Further communication takes place, with shareholders and other external parties, through the committee's report included in the published report and financial statements. The Combined Code (2006) also requires the committee Chair to be available to answer shareholders' questions at the annual general meeting (AGM).

This paper reflects the discussions of a meeting of the Audit Committee Chair Forum (ACCF) held on 11th April 2007 to address the issue of audit committee communication, both externally and internally within the company. Additionally it draws upon published sources, upon telephone interviews with five members of the ACCF (two of whom attended the meeting) and upon interviews and discussions previously conducted with members of the ACCF.

The interviews and meeting directly related to this matter solicited the views of ten Chairs of the audit committees of leading companies, and three audit partners from Ernst & Young.

The paper sets out some of the issues relating to audit committee communication. In particular, it deals with communication between the committee and the Board, and between the committee and investors. In the light of a growing trend towards increased governance disclosures, it goes on to consider the future direction of audit committee communication.

The formal questions addressed in the briefing document circulated prior to the ACCF meeting are set out in Appendix 1.

In dealing with the issue of audit committee communication, the meeting spent some time discussing the role of the committee vis-à-vis the Board, taking the view that this must be reflected in the nature of such communication. That too is discussed in this paper.

The Audit Committee and the Board

“Everything is the Board’s responsibility. The issue is what do they delegate to the audit committee to look at in detail on the Board’s behalf? Where is it best handled?”

The audit committee acts on behalf of the Board. Unlike a remuneration committee, which is specifically required to make recommendations, a large part of the work of the audit committee is more that of review, taking on a role that is too complex and time-consuming to be dealt with by the Board as a whole. This leads to an interesting Board-audit committee relationship, and one that reflects the context of each individual company.

For example, in some companies risk management is the responsibility of the audit committee, whereas others have a separate risk committee. Also, some choose to have all of the non executives sitting on the audit committee, and the executive directors in attendance; in other companies audit committee attendance is limited.

This situation was described in the ACCF meeting as: *“The audit committee has no unique responsibility”*, by which was meant that it deals with matters delegated by individual Boards to suit their own circumstances, rather than having a clear list of decisions and recommendations to make. Because of this, committee communication has to be tailored to the company’s situation.

Nonetheless, as a Board sub-committee, the audit committee needs to ensure that Board members are fully informed about its work, without overwhelming them with unnecessary detail. Methods of providing such feedback are through the committee’s formal minutes, and through oral reports at Board meetings. Board members need to be informed about the committee’s work in order to carry out their roles, and also to meet their statutory responsibilities regarding communication with the auditors.

Minutes, and oral reports to the Board

Minutes and reports from the audit committee serve three distinct purposes: to enable the committee’s recommendations and requirements to be actioned; to inform fellow Board members; and to meet regulatory obligations.

Producing the minutes

“Is there a feedback loop to ensure that things are done?”

There is no standard practice for the preparation and distribution of minutes of audit committee meetings, and each company adopted a different approach, in some cases significantly different.

The broad process is that the minutes are generally prepared by the Company Secretary, reviewed by the Chair of the meeting, and tabled for formal approval

at the next meeting. Committee meeting minutes, having been approved, are presented to the Board. However, in some companies this was done very quickly, with the committee Chair playing a major role, whereas in others the process was more convoluted.

Table 1 gives some examples of the practices encountered.

Table 1 Examples of different companies' processes for producing minutes of audit committee meetings
<ul style="list-style-type: none"> • The Company Secretary types up notes during the meeting, as a basis for minutes which are distributed very quickly. • Within a week of the meeting the Company Secretary produces draft minutes for the committee Chair's approval. Suggested corrections are processed, and the finalised minutes are immediately circulated to committee members. • Up to three months after the meeting the Company Secretary sends draft minutes to the committee Chair for approval and subsequent distribution, just in time for the next meeting. In the meantime, lists of action points have been sent separately to those charged with action. • Draft minutes are produced jointly by the Company Secretary and the Head of legal affairs. They go for review to the finance director and external auditors before the committee Chair sees them. This process takes some time, and minutes are generally available just in time for the next meeting.

Those committee Chairs in companies where minute-production was a long-winded process would have preferred it to be streamlined, but were attempting to manage change in long-established corporate culture and practices.

Despite the diversity of practices, it was generally agreed that if minutes are to be useful they need to be produced soon after the meeting, in order that action points can be addressed. And if minutes are to be accurate then, again, they need to be produced shortly after the meeting, whilst people's memories are fresh. In those companies where the minutes were produced some time after the meeting, the committee Chairs took their own notes to use as a reference point: this is not ideal, as it can detract from the process of chairing the meeting.

No matter what practice is followed as regards the minutes, in all companies, members confirmed that action points are followed up at subsequent meetings.

Content of the minutes

"There is a danger... that some of these things do get smoothed out rather than clearly documented."

"I [often] find myself presented with pretty anodyne minutes... I sometimes find myself splicing back into the minutes."

It is notable that some of the most interesting meetings may have the most boring of minutes. Minute-writing is an art, and in some companies the minutes are bland and uninformative, giving the minimum of information needed to meet regulatory requirements. Other companies will produce full minutes,

from which a flavour of the meeting can be obtained. Practices discussed with the ACCF members varied between companies, and the general view was that minutes tended to reflect the style of the individual Company Secretaries who drafted them, despite the fact that the Chairs themselves might have appreciated something different.

One point raised in this regard was that the Company Secretary is him/herself a member of the executive of the company, and so may have an incentive to soften the tone of any record of discussions that made the executive team look bad. The committee Chair needs to guard against this.

Interestingly, not only was there a divergence of practice, there was also a divergence of opinion amongst ACCF members as to what the minutes should cover. As discussed in the next section, some took the view that a record of *“there was a discussion and here is our conclusion”* was perfectly adequate; others demanded a much more discursive style, giving a feeling for the underlying discussions.

In some companies, the supporting papers presented to the audit committee are circulated to other Board members; in most (but not all) they are made available should those other members wish to see them. If this is the case, it can be argued that the minutes themselves can include less detail (although a wodge of paperwork is not necessarily a user-friendly solution for the reader).

A point was made about at least one company that audit committee minutes were much less informative than the minutes of the remuneration and nomination committees. One reason given for this was that the role of the audit committee is to review, whereas remuneration committees have, for example, to record and explain their justification of pay awards, and nomination committees their reasons for appointments and promotions. Table 2 sets out extracts from the Combined Code which support this argument.

Table 2 Differences between the three main Board committees per the Combined Code (2006)		
Nomination committee	Remuneration committee	Audit committee
Leads the process for Board appointments and makes recommendations to the Board. (A.4.1)	Has delegated responsibility to set executive remuneration, and should make recommendations regarding senior management remuneration. (B.2)	The Board should present a balanced and understandable assessment of the company's position and prospects. (C.1)
		The Board should maintain a sound system of internal control, and should, at least annually, conduct a review. (C.2)
		The committee should monitor and review financial statements and internal controls. (C.3)
		The committee should make recommendations regarding the engagement of the external auditors. (C.3)

From this it can be seen that although the committee might need to prepare detailed minutes to justify its decisions regarding the external auditors, the majority of its work is monitoring and reviewing, which is subtly different from the work of the other committees. (This point is also relevant later in this report, when we discuss communication with investors.)

Finally, one Chair commented that, as a company regulated by the Financial Services Authority, the minutes of his audit committee were available for review by the Regulator. The fact that an outside body had access had led to a very spare style of minutes, recording conclusions and action points, but with no detail of the discussion: matters of detail were dealt with in oral presentations.

“Where it’s something the rest of the Board needs to know, we do it by oral report.”

The ACCF members generally took the view that any requirement for committee minutes to be available for review by outsiders would inevitably lead to a briefer record being produced. Indeed, it was suggested that the need to disclose more might “force it underground”, and some matters would be cleared up ‘informally’ before the meetings instead of at them.

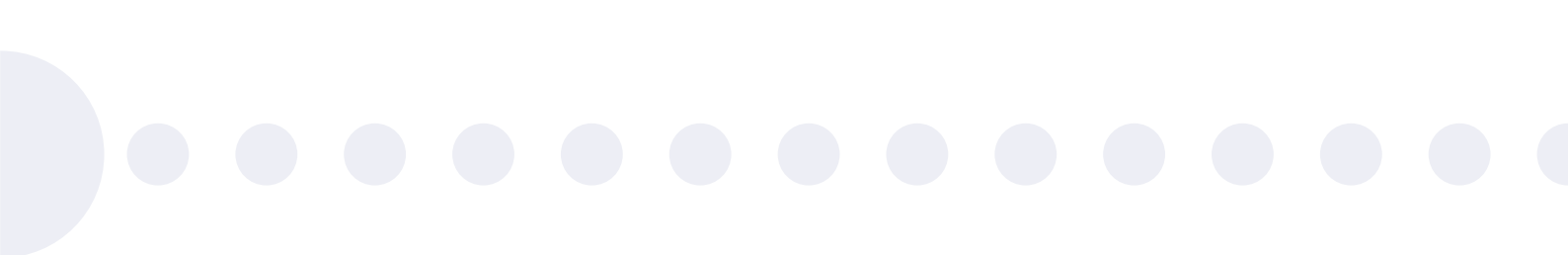
Relevance of the minutes

“Apart from chasing action points, what is the use of minutes?... How often have you gone back to refer to the minutes?”

“Audit committee is an area where these things [e.g. a degree of conflict between the FD and CEO and/or the auditor] can get raised: it’s useful to be able to document these issues.”

One area of disagreement between the ACCF members was the relevance of audit committee minutes. The quotes shown above demonstrate contrasting views. To the first Chair, by the time the minutes are produced, the committee has already made its oral report to the Board (see next section), and so the minutes themselves are a dead, historical record. However, other members reported that they did occasionally refer back to the minutes, and one argued particularly strongly that they were a useful document.

Although some saw little point in the minutes, an equally firm opinion held by others was that detailed and discursive minutes that capture the flavour of a discussion can focus the attention of the committee, and, specifically, can be of great help to a finance director (FD) who needs, perhaps, to stand up to the CEO or other executives on certain matters. A record of matters being raised, sometimes regularly, can highlight any areas of tension, and eventually assist with their resolution. This supported their view that minutes should not be anodyne.



Additionally, it was suggested that the circulation of informative audit committee minutes to management can have a positive impact on behaviour within the organisation, and can emphasise the committee's role.

Furthermore, it was considered to be a useful practice for the minutes to document management's views on judgemental areas in the financial statements: this is particularly useful as a guide to those Board members not present at the audit committee meetings.

Oral reports to the Board

The practicalities of running a Board of directors mean that audit committee meetings are often held in the same week, possibly on the same day, as Board meetings. This being the case, the committee minutes presented to the Board will be those of the previous meeting. This is inevitable, but not very helpful. Accordingly, in companies where not all of the directors attend the audit committee, it appears to be practice for the audit committee Chair to make an oral report to the Board setting out what has happened in the most recent audit committee meeting. This oral report was universally considered to be more useful and important than the committee's formal minutes.

As an example, in one company, where the Board meeting is the day after the audit committee, the committee Chair makes an oral presentation lasting about ten minutes, which is followed by the circulation of lengthy minutes to the full Board about a week and half later.

In companies where all of the non executive directors (NEDs) sit on the audit committee, either as members or in attendance, there is little need for discursive minutes or an oral report, as everyone should know what has happened. Furthermore, in many companies the only executive members of the Board are the CEO and the FD; the latter is usually in attendance for audit committee meetings, and the former often attends. Where this is the case, again the need for Board reporting is reduced.

Communication between Board committees

One further point raised at the ACCF meeting was the importance of good communication between the audit committee and the remuneration committee. With many performance-related awards being made to executives on the strength of accounting numbers, both parties need a clear understanding of the potential impact on pay of, for example, judgements on accounting treatments.

Communicating disclosures to the auditors

“Tell us what you don’t know that you don’t know, to paraphrase Rumsfeld!”

Directors have a legal requirement to ensure that all relevant disclosures have been made to the company’s auditors (Companies Act 2006, s.418 – see Appendix 2). This is a responsibility of directors individually, rather than of the Board collectively.

This requirement is relatively new (it came in for periods commencing on or after 1st April 2005), and there is no precedent in this area, with the result that Boards and their advisors are unclear as to what needs to be done to ensure that they are aware of the issues. In some companies the matter is taken very seriously; in others, less so.

The ACCF meeting and interviews discussed the role of the audit committee in communicating with the rest of the Board what they have disclosed to the auditors. This is particularly relevant to those who do not attend audit committee meetings. The view of the ACCF meeting was that it is probably the role of the committee Chair to keep informed any NEDs who did not attend the committee meetings, and the job of the FD to brief any Board executives in a similar position.

However, it is important to understand that, as a non executive committee, the audit committee is not the primary source of communication and disclosure to the auditors – this will come from the finance department and other executives. Thus, it was agreed that the most crucial role for the audit committee is to ensure that processes are in place so that executives can make the Board aware of such disclosures.

In one company this has been addressed by the Chair of the committee formally reporting that the committee has communicated fully with the auditors, and asking the CEO to confirm likewise and also to confirm that procedures are in place for his/her subordinates to do the same. In all, the committee’s role is seen as one of process rather than itself managing the detail of the disclosures.

The process in another company is for executives to confirm to the CEO that all appropriate disclosures have been made, and the CEO to confirm this to the Board. This is done at a meeting where each director (executive and non executive) individually confirms that s/he has not withheld any relevant information from the auditors. In this way, all directors are seen to have made proper enquiries as to disclosures, and the minutes record this fact.

The Audit Committee and the Investor

*“What is the point of adding an extra paragraph or several paragraphs when you are pretty confident that the investors aren’t going to read it?! ... What they want is to sit down with the audit committee and ask what was done. They don’t bother to attend the AGM when they **could** ask about it.”*

Potentially, there are two main channels for communication between the audit committee and investors: the written report of the committee, set out in the published financial statements, and the availability of the committee Chair to answer questions at the AGM. In addition, there is the potential for significant investors to ask questions in one-to-one meetings during the year.

The published report of the audit committee

“It’s not clear what it’s for... I’m not clear what decision-relevance it’s going to have... the case was never made for it being a good thing, [it was just assumed that it was].”

“It’s very difficult to see how you’d make these things more meaningful.”

Background

“Everyone is very keen ... that it taps hitherto unknown methods of communicating with shareholders... The fact is that there is a standardised format, and it’s there for a good reason. One, you need to cover everything, so we all tell a similar story... And two, the desire not to be sued... The fact is that unless the lawyers crawl all over this stuff you open yourself up to legal action and the risk of Americans coming over...”

The published report of the audit committee, included in the annual report and financial statements, is its primary form of communication outside the company. The main requirement of the Combined Code (2006) as regards this report is that it describes the work of the committee in discharging its responsibilities in the year (see Appendix 3). This is fleshed-out in the Smith Guidance (2003) (see Appendix 4). In particular, Smith outlines the content of a report on the activities of the audit committee: this sets out the standard details of membership, number of meetings, attendance, etc. and also a statement of the activities carried out by the committee to discharge its duties.

In preparation for the ACCF meeting, an informal review was conducted of the published audit committee reports of ten listed companies with 2006 financial year ends. This indicated that their reports are, perhaps unsurprisingly, similar. In length, they ranged between half a page and two pages, although this is

slightly misleading, as some companies chose to include general governance information within those paragraphs, whereas others included relevant audit committee information in other parts of their annual report. Some made mention of their terms of reference; some set out those terms in outline; and some listed out the specific areas reviewed by the committee in the year.

A few of these reports go into reasonable detail to list what the committee has done in the year. However, there is an inevitable sameness about them. Disclosures are made, but they are not necessarily informative, and they reflect no detail of what was actually discussed, and what areas of contention existed.¹

“All one would have would be more anodyne statements that won’t actually add more information, but would give the impression of adding more information.”

Discussion

“There’s a danger of giving the audit committee responsibility and credibility that it does not have... Talking about this and getting involved in the debate... that’s what would worry me, that people would assume we’d done a lot more.”

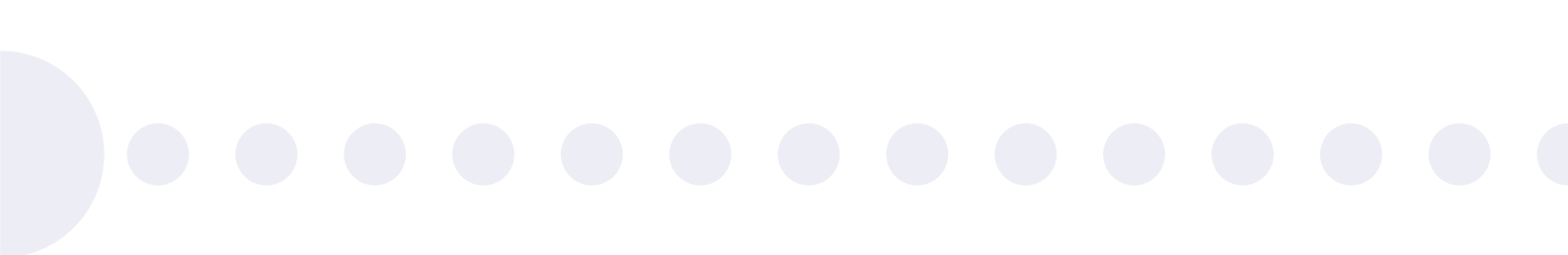
The ACCF meeting and discussions were somewhat dismissive of the published report of the audit committee, suggesting that it is not considered to be a particularly important document. It is seen as a ‘boilerplate’ text, generally prepared by the Company Secretary, whose job it is to ensure that all the required information is disclosed. Although the audit committee Chair has the opportunity to amend the draft report, it is rare for such amendments to be significant. However, one Chair (interviewed separately to the ACCF meeting) had initiated a review of the format and content of the report, with a view possibly to extending them.

An important discussion at the ACCF meeting revolved around the duties of the audit committee, and, therefore, the matters on which it should be expected to report. The view was expressed strongly that the committee, as a non executive body, is concerned with ensuring that processes are in place, and reporting to the Board (see Table 2), but is not responsible for any executive activities. This being the case, it was considered inappropriate for the committee to, effectively, take responsibility for Board or executive matters by discussing them in its report.

It was agreed that, by definition, the audit committee must have agreed with the final disclosures in the financial statements. Accordingly, there seemed little point in stating this fact. If any matters of judgement were important to an understanding of the financial statements, they should be separately disclosed as such anyway, and not just included in a governance report.

“If there is an issue, then we properly direct attention there. Rather than saying that it’s the role of the audit committee to say that – it’s the role of the financial statements to say that.”

¹ For example, the committee’s report in Marks and Spencer’s financial statements states, “Items reviewed during the year include: General Merchandise stock commitment controls, Food new product development process, business continuity planning and controls over advertising expenditures and payroll.” This is a lot more specific than most companies’ disclosures, but the ACCF meeting did not see this information as being particularly valuable to readers.



Several other points were also raised about the need – or otherwise – for detailed disclosure in the published report. Firstly, the work of the audit committee is sometimes a process of gentle encouragement to change practices over the longer-term; having to produce an annual report in detail could stifle such initiatives, as phrases such as “the audit committee again considered...” might be seen as inappropriate. And secondly, doubt was cast as to whether additional disclosure added anything of relevance.

It was suggested that, despite the recommendations of the Smith Guidance, the audit committee report could, without loss, be reduced to:

- We have met all the requirements of our published Terms of Reference;
- We have reviewed the report and accounts, and there is nothing that should be disclosed that has not been.

Whilst this is possibly unrealistic in the current governance climate, it was felt that such statements did provide as much assurance to investors as did the current reports, albeit in fewer words.

In contrast, one ACCF member argued that the current governance environment appears to be demanding additional disclosure, whether or not it is deemed useful or proper. Because of this, if companies did not extend their disclosures they could fall victim to ‘creeping regulation’. Accordingly, it may be appropriate to set out how the committee has addressed its role during the year. But this has to be set against the ever-increasing size of corporate reports, and their tendency to be comprehensive, rather than comprehensible. The view was expressed that additional disclosure had not, by and large, increased trust in business.

It was noted that investors may be nervous about corporate underperformance, and about non executive ‘capture’ by the executives. The ACCF meeting appreciated these views – whilst not fully accepting them – but the sentiment was that increased disclosure was unlikely to set minds at ease.

“If you believe there is a conspiracy, then someone telling you that there is not a conspiracy doesn’t assure you!”


Communication at the Annual General Meeting

Current regulation states that the audit committee Chair should be available at the AGM to answer questions about the work of the audit committee. This is a passive role, and it appears that such questions are tabled in relatively few companies; only one of the Chairs participating in these discussions had ever been asked a question at AGM, and that question was on a matter of detail better dealt with by the FD.

Informal communication with investors

“Risk identification is a collective task; management of the risk must be with the executives. Therefore it can’t be an audit committee issue.”

In addition to their formal communication with the body of investors and stakeholders, quoted companies regularly have meetings with major shareholders. Much of this discussion takes place with executives rather than the NEDs as, somewhat obviously, they are better-informed. However, NEDs do get involved on occasion. In this regard, the ACCF meeting expressed the view that they as committee Chairs should not be discussing matters of detail, other than about the committee’s workings.



One ACCF member commented on his company's Investor Day, during which institutional investors have the opportunity to address questions to the audit committee Chair. In previous years such questions have been outside the scope of matters he was prepared to address, dealing with specific accounting judgements best referred to the FD. However, questions this year had revolved around the workings of the audit committee and how it operated; these were considered useful and appropriate for discussion, as they related to the audit committee, and informed the shareholders without disclosing market-sensitive information.

Generally, it was noted that companies have communication with both the investing side of institutional shareholders and with their corporate governance arms. It was felt that considerable resource is expended – by the institutions and by the companies – in dealing with corporate governance issues, but that these are not seen as very important by the investment arms. It was further suggested that an increased emphasis on potentially irrelevant governance matters could be one driver of the growing trend in taking listed companies private.

Is further communication necessary or desirable?

“The remuneration committee has defined responsibilities. The audit committee covers the whole spectrum – there is no unique responsibility... you need to look at the Board, as that’s where the responsibility lies.”

“More reporting wouldn’t have stopped Enron.”

The governance arms of some institutional investors and their representative bodies (e.g. the ABI and NAPF), have indicated that they would like the chance to be able to discuss matters privately with the Chair of the audit committee in the same manner as they do with the Chair of the remuneration committee, as have other governance organisations². Such communication, specifically as regards the audit committee, does not appear to take place at the moment. Indeed, the participants at the ACCF discussion were strongly and unanimously of the view that it would be inappropriate, for two reasons: disclosure of private information, and committee responsibilities.

The point regarding private information was that if information is disclosed, companies are legally obliged to make it available to all shareholders at the same time, to avoid any possibility of insider trading. Although private discussions do take place with major investors, these are around matters of clarification rather than presenting new information.

The second point, regarding committee responsibilities, has been mentioned several times in this report: the audit committee differs from other Board committees. It monitors and reviews, rather than making decisions and recommendations. This being the case, the ACCF members considered that it is far more appropriate for such communication to be dealt with at Board level, rather than by direct communication from the committee. Also, as one of the telephone interviewees pointed out, investors receive much less information about remuneration than they do about the financial statements, and so the need for communication differs.

“It is a completely misguided idea, and a rather sloppy piece of thinking as regards the comparison with the remuneration committee... The audit committee’s job is to assure itself about the integrity of the accounts. The accounts are there in glorious detail with everything spelled out... The level of disclosure is colossal, and there’s absolutely no scope at all for telling people more than was told to them in the accounts.”

² For example, the response by Governance for Owners to the Financial Reporting Council’s Discussion Paper on Choice in the UK Audit Market, which suggests that allowing shareholders a discretionary vote on the audit committee’s report would facilitate shareholder conversations with audit committee Chairs.

Despite this, the meeting noted that there is a movement to obtain more information about the committee's operations. In early 2007 a working party brought together by the Audit & Assurance Faculty of the ICAEW³ considered the views of investors and other stakeholders in auditor reporting. This working party's recommendations included extending the wording both of the auditors' statutory report and the audit committee's report in order to make them more informative to investors and others. For example, the investors were interested in:

- More information about emphases of matter and references to uncertainty and future risk;
- Discussion of material issues encountered during the audit and their resolution;
- Tailored auditor reports (rather than the current standardised wording);
- Alternative accounting treatments considered, and the reasons for adopting the treatments chosen;
- Information on material areas of judgement, and difficult or sensitive issues.

The working party's report suggests that one avenue for such reporting could be to extend the audit committee's published report. This was a matter for considerable debate in the ACCF meeting: the conclusion was, strongly, that before disclosures are expanded, investors need to explain why they need such additional information and what use it might serve.

³ *Audit Quality: Fundamentals – Auditor Reporting*. Audit & Assurance Faculty, Institute of Chartered Accountants in England and Wales, London, 2007.

Questions to ask yourself?

- 1 How do we ensure that the Board is kept fully informed about audit committee work?
- 2 Is our process for producing audit committee minutes rigorous and timely? Could it be improved? Do the minutes provide sufficient information for adequate follow-up?
- 3 Why does our published audit committee report take its current format? Should it be revised?
- 4 Is there any need to extend the level of communication between the audit committee and investors?

Appendix 1

Questions included in the briefing document circulated prior to the ACCF meeting on 11th April 2007

- 1** Who drafts and who approves the minutes of your audit committee meetings? What is the timescale for their preparation and distribution?
- 2** Given the legal liabilities of the Board, how does your audit committee ensure that all Board members, executive and non executive, are au fait with disclosures made to the auditors?
- 3** How important is the audit committee's published report in the financial statements? Who is responsible for its design, drafting, modification and approval? What is the timescale for its production?
- 4** Is there a role for the audit committee to comment externally on the discussions the committee has had with the finance team and/or auditors? If such commentary is appropriate, should it be included in the published report of the committee; should it take the form of an oral presentation at the AGM; or should it be conducted privately between the committee Chair and major investors?

Appendix 2

Companies Act 2006 Requirement Regarding Disclosures to the Auditors

Section 418

Contents of directors' report: statement as to disclosure to auditors

- 1) This section applies to a company unless:
 - a) it is exempt for the financial year in question from the requirements of Part 16 as to audit of accounts, and
 - b) the directors take advantage of that exemption.
- 2) The directors' report must contain a statement to the effect that, in the case of each of the persons who are directors at the time the report is approved:
 - a) **so far as the director is aware, there is no relevant audit information of which the company's auditor is unaware, and**
 - b) **he has taken all the steps that he ought to have taken as a director in order to make himself aware of any relevant audit information and to establish that the company's auditor is aware of that information.**
- 3) "Relevant audit information" means information needed by the company's auditor in connection with preparing his report.
- 4) A director is regarded as having taken all the steps that he ought to have taken as a director in order to do the things mentioned in subsection (2)(b) if he has:
 - a) made such enquiries of his fellow directors and of the company's auditors for that purpose, and
 - b) taken such other steps (if any) for that purpose, as are required by his duty as a director of the company to exercise reasonable care, skill and diligence.
- 5) Where a directors' report containing the statement required by this section is approved but the statement is false, every director of the company who:
 - a) knew that the statement was false, or was reckless as to whether it was false, and
 - b) failed to take reasonable steps to prevent the report from being approved, commits an offence.



Appendix 3

Extracts From The Combined Code (2006)

Regarding Audit Committee Communication

- C.3.3 The terms of reference of the audit committee, including its role and the authority delegated to it by the board, should be made available. A separate section of the annual report should describe the work of the committee in discharging those responsibilities.
-
- C.3.5 The audit committee should monitor and review the effectiveness of the internal audit activities. Where there is no internal audit function, the audit committee should consider annually whether there is a need for an internal audit function and make a recommendation to the board, and the reasons for the absence of such a function should be explained in the relevant section of the annual report.
- C.3.6 The audit committee should have primary responsibility for making a recommendation on the appointment, reappointment and removal of the external auditors. If the board does not accept the audit committee's recommendation, it should include in the annual report, and in any papers recommending appointment or re-appointment, a statement from the audit committee explaining the recommendation and should set out reasons why the board has taken a different position.
- C.3.7 The annual report should explain to shareholders how, if the auditor provides non-audit services, auditor objectivity and independence is safeguarded.
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- D.2.3 The Chairman should arrange for the Chairmen of the audit, remuneration and nomination committees to be available to answer questions at the AGM and for all directors to attend.

Appendix 4

Extracts From The Smith Guidance (2003) Regarding Audit Committee Communication

- 1.6. The Code provides that a separate section of the annual report should describe the work of the committee. This deliberately puts the spotlight on the audit committee and gives it an authority that it might otherwise lack. This is not incompatible with the principle of the unitary board.
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- 4.9 The audit committee should monitor and review the effectiveness of the company's internal audit function. Where there is no internal audit function, the audit committee should consider annually whether there is a need for an internal audit function and make a recommendation to the board, and the reasons for the absence of such a function should be explained in the relevant section of the annual report.
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- 4.17 The audit committee should have primary responsibility for making a recommendation on the appointment, reappointment and removal of the external auditors. If the board does not accept the audit committee's recommendation, it should include in the annual report, and in any papers recommending appointment or reappointment, a statement from the audit committee explaining its recommendation and should set out reasons why the board has taken a different position.
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- 4.32 The annual report should explain to shareholders how, if the auditor provides non-audit services, auditor objectivity and independence is safeguarded.
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5 Communication with shareholders

- 5.1 The terms of reference of the audit committee, including its role and the authority delegated to it by the board, should be made available. A separate section in the annual report should describe the work of the committee in discharging those responsibilities.
- 5.2 The audit committee section should include, inter alia:
- a summary of the role of the audit committee;
 - the names and qualifications of all members of the audit committee during the period;
 - the number of audit committee meetings;
 - a report on the way the audit committee has discharged its responsibilities; and
 - the explanation provided for in paragraph 4.29 above. [Details of the formal policy regarding non-audit work by the external auditors.]
- 5.3 The Chairman of the audit committee should be present at the AGM to answer questions, through the Chairman of the board, on the report on the audit committee's activities and matters within the scope of audit committee's responsibilities.



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